Extended Repayment Plan
Benefits and Costs for the Borrower

Description of Extended Repayment Plan

The Extended Repayment Plan offers borrowers of Federal Stafford, Federal PLUS and Federal Consolidation Loans the ability to extend the repayment period of these loans up to a 25-year term using either fixed or graduated monthly payments. It is available in both the Federal Family Education Loan (FFEL) and Federal Direct Loan (FDL) programs. To qualify, FFEL borrowers must have first borrowed an FFEL loan on or after October 7, 1998, or have on the date they obtained the post-October 7, 1998 FFEL loan, had no outstanding balance on a FFEL loan obtained prior to October 7, 1998. They also must have FFEL loan debt (outstanding principal and interest) in excess of $30,000. Comparable eligibility requirements apply to FDL borrowers.

Extending repayment reduces the required minimum monthly loan payment although it increases the total amount of interest paid. As such, this repayment plan offers borrowers payment relief that can benefit them in several ways. The added interest cost of doing so may or may not be financially detrimental based on how the borrower uses the added cash flow that is created by the reduction in monthly loan payments.

Benefits and Costs

There are three potential positive benefits from extending repayment on federal student loans for a borrower. It can increase monthly cash flow so that the borrower can:

- Afford the minimum monthly loan payment and pay all other monthly expenses as well, thereby preventing default;
- Repay more expensive debt such as credit card debt and loans with higher interest rates thereby reducing the overall cost of his or her total debt obligations; and/or
- Invest in a new home or other long-term investments such as a retirement account thereby increasing total wealth.

<u>Affordable Monthly Loan Payment</u>

Student loan indebtedness is growing faster than average starting salaries for many graduates. As such, many borrowers may find repaying their student loan debt unaffordable using the Standard Repayment Plan that provides for fixed monthly payments over a ten-year repayment period. Although the Standard plan results in the lowest amount of interest paid, it also requires the highest initial monthly loan payment; a payment that many borrowers may not be able to afford given their other monthly living expenses. Extending repayment to 25 years using the Extended Repayment Plan can reduce the monthly payment by as much as 40% on a Federal Stafford Loan having a fixed interest rate of 6.8% as demonstrated in the chart below.

Loan Principal	Stafford Loan			
	Monthly Payment		Difference ($)	Difference (%)
	6.80%			
	Standard Plan 10 Years	Extended Plan 25 Years		
$1,000	$11.51	$6.94	$4.57	40%
$10,000	$115.08	$69.41	$45.67	40%
$25,000	$287.70	$173.52	$114.18	40%
$50,000	$575.40	$347.04	$228.37	40%
$60,000	$690.48	$416.44	$274.04	40%
$75,000	$863.10	$520.55	$342.55	40%
$100,000	$1,150.80	$694.07	$456.73	40%
$125,000	$1,438.50	$867.59	$570.91	40%
$150,000	$1,726.20	$1,041.11	$685.10	40%
$175,000	$2,013.91	$1,214.63	$799.28	40%
$200,000	$2,301.61	$1,388.14	$913.46	40%

For example, a borrower owing $60,000 in Federal Stafford Loans would be required to pay $690.48 per month for 10 years using the Standard Repayment Plan (see shaded line in chart shown above). The minimum monthly loan payment would be reduced to $416.44 using the Extended Repayment Plan over 25 years. This is a decrease of $274.04 per month and might mean the difference between the borrower being able to afford his or her basic living expenses or not, being able to live alone versus having to live with a roommate, paying for gas and other utilities or not, paying for health insurance or being uninsured, etc.

In general, extending repayment of a loan will increase the amount of interest paid on that debt. And on the face of it, paying more interest would appear to be a negative financial outcome. However, the increase in interest paid does not necessarily mean an equal loss of purchasing power over time due to the time value of money. Over time, the purchasing power of a dollar declines due to inflation. The higher the rate of inflation, the faster that rate of decline. In fact, if the rate of inflation is high enough, the loss of purchasing power may actually be less for a stream of payments made over a longer period of time than when the rate of inflation is low even if more total interest is paid.

Furthermore, borrowers have the right to make prepayments on their federal student loans without penalty and so they could choose the extended plan and make prepayments if desired in times when inflation was low to offset the corresponding increase in loss of purchasing power.

<u>Repaying Higher Cost Debt</u>

Extending repayment on lower cost federal student loans may allow borrowers to repay higher cost debt more quickly. Borrowers who have multiple types of outstanding debt (e.g., private student loans, credit card debt, auto loans) with different interest rates could benefit financially if they could pay off the highest cost debt as quickly as possible. Using the added cash flow that would result from extending repayment on federal student loans could accommodate that debt management strategy.

Ability to Invest

Borrowers may benefit financially from extending repayment even in cases when they feel they can afford the monthly payment required under the Standard 10-year fixed payment plan if they invest the added cash flow from a reduced monthly loan payment. This investment might be the purchase of a home or investing in a tax-deferred retirement account. With the purchase of a home (assuming the borrower could not otherwise afford this purchase without the added cash flow created by extending repayment), the borrower likely could reduce his or her federal income tax liability because the mortgage interest could be itemized as a tax deduction. The home also represents an asset that hopefully would gain in value over time.

In the case of investing for retirement, the borrower would be better off financially as long as the rate of return on the retirement account was greater than the interest rate of the loans being repaid more slowly using extended repayment. The following example illustrates the potential financial benefit of choosing the extended plan over the Standard 10-year plan and investing the difference in monthly loan payments required under the two plans.

Payments 1-120 *(First 10 years)*		
	Standard Repayment Plan	Extended Repayment Plan
Total months in repayment	120	300
Total loan amount owed	**$60,000**	**$60,000**
Loan interest rate	**6.8%**	**6.8%**
Monthly loan payment	$690	$416
Monthly investment contribution	$0	$274
Annual rate of return on investment	8%	8%
Total assets earned at end of 120 months	$0	$43,136
Payments 121-300 *(Years 10-25)*		
Monthly loan payment	$0	$416
Monthly investment contribution	$690	$274
Total assets earned at end of 300 months @ 8%	$212,536	$237,461
Total cash flow out *($690*300 months)*	$207,000	$207,000
Net gain	$5,536	$37,461
Net benefit of Extended Repayment Plan		$31,925

As this example illustrates, the borrower would have $31,925 more in assets if he or she used the extended plan and where the $274 difference in monthly loan payments was invested every month from the beginning of loan repayment. Had the borrower paid off the $60,000 loan debt using the Standard plan, he or she would be debt free sooner, but would have less invested for the future.

What Should Borrowers Do?

The right payment plan for a borrower ultimately depends on his or her financial goals and available financial resources, i.e., monthly budget. In general:

- For the borrower who wants to be debt free as soon as possible, paying off the loans as fast as one can afford likely is the right choice—Standard Repayment (10-year plan).

- For the borrower who cannot afford Standard Repayment or who wants additional monthly cash flow for other purposes (such as buying a home or investing for retirement), extending repayment over 25 years likely is the best option. And since the borrower has the right to prepayment without penalty, they always could pay off the debt in less than the 25 years allowed if they so choose.

When Is Federal Loan Consolidation The Right Option?

Federal loan consolidation also allows borrowers to reduce their monthly loan payments by refinancing their debt over a longer repayment period. And this may be a better option than choosing the Extended Repayment Plan in the following cases:

- Borrower has Federal Stafford Loan debt with a variable interest rate

  Federal Consolidation Loans have a fixed interest rate and so borrowers who have variable rate Stafford Loans (loans first disbursed before July 1, 2006) could fix the rate on their debt with consolidation. However, many borrowers with variable rate debt have already consolidated that debt as a result of marketing campaigns that encouraged them to do so when variable rates were low in recent years.

  Those who did not consolidate their variable rate debt seem unmotivated to do so. Furthermore, they may be better off waiting to see if rates decline further in the coming years before they consider consolidating their variable rate loan debt. In the interim, choosing the extended plan still could be a good financial step.

- Borrower has multiple federal loan holders/servicers

  For borrowers who have borrowed their federal student loans from multiple lenders and now have more than one loan holder/servicer, refinancing all their debt through consolidation could simplify managing repayment of that debt.

- Borrower wants to reduce the interest rate on Federal PLUS Loan(s)

  The current interest rate on Federal PLUS Loans (for both parent and graduate borrowers) is fixed at 8.5% in the FFEL Program and at 7.9% in the Direct Loan Program. The interest rate on Federal Consolidation Loans (in both the FFEL and Direct programs) is calculated as the weighted average of the interest rates on the loans being consolidated rounded up to the nearest 1/8th percent. But it is capped at 8.25%. If borrowers were only consolidating FFELP PLUS loans, the weighted average would be 8.5%, but the resulting rate on their Consolidation loan would be 8.25% because of the rate cap. As such, borrowers could get a lower interest rate on their FFELP PLUS Loan debt if they refinanced it through consolidation. Those with Direct PLUS loans would have a weighted average of 7.9% that when rounded to the nearest 1/8th percent would be 8.0%. Thus, consolidation of Direct PLUS Loans would actually increase the interest rate charged on the debt.

- Borrower wants to take advantage of the new Loan Forgiveness for Public Service Employees Program created by the College Cost Reduction and Access Act of 2007 (CCRAA)

  This new loan forgiveness program is available only to Federal Direct Loan Program borrowers. Borrowers of FFELP loans are not eligible, but they can consolidate into the Direct Program in order to take advantage of this forgiveness program. To qualify for loan forgiveness, borrowers must work full-time for at least 10 years in a qualifying public service position and be making payments on their Federal Direct Loans using either income-based repayment, income continent repayment, or paying an amount that is at least equal to the amount that would be required using the Standard 10-year fixed repayment plan.

  It is likely that very few professional-degree borrowers ultimately will qualify for this loan forgiveness program because of the 10 year public service employment requirement. For example, public interest lawyers would qualify for this program provided they work in qualifying positions for at least 10 years. Historically, this would apply to less than 5% of all law school graduates. Therefore, for the few who will qualify for this forgiveness, consolidation in the Direct Program will be a beneficial step. But it is not an action than most of our borrowers should consider.

Consolidation also has potential costs that could offset or out weight the potential benefits listed above.

- Loss of borrower benefits

  Borrowers who consolidate will lose any borrower benefits they might qualify for on the underlying loans. For example, borrowers would lose any on-time payment benefits (such as an interest rate reduction) if they consolidate the loans that qualified for such benefits. Furthermore, most FFELP lenders have ceased offering Federal Consolidation Loans due to the subsidy cuts imposed by the CCRAA. (Although Access Group does not currently offer Federal Consolidation Loans, we still provide information about this loan refinancing option as part of our borrower education program and include information about it on our Web site.) Thus, borrowers likely would have to consolidate in the Direct Program. And that program only offers a 0.25% interest rate reduction for making auto-debit payments. As such, borrowers could end up with a higher interest rate on their consolidation loan than they would have had on their underlying loans had they not consolidated. This is even true in the case of the PLUS loan. Access Group borrowers are eligible for at least a 1.0% interest rate reduction after making their first on-time payment for PLUS loans first disbursed between July 1, 2006 and October 31, 2007, as well as a 0.25% interest rate reduction for auto-debit payments. Thus, they could end up with a rate of 7.25% on their PLUS loan with Access Group. The best they could get on that debt with a Direct Consolidation Loan would be 8.0% after signing up for auto-debit payments.

- Added five years in repayment

  Borrowers with at least $60,000 in federal student loans debt would be eligible for a 30 year repayment period on their consolidation loan. And while this will reduce their monthly payment a bit more than if they chose extended repayment, they also will be in repayment five years longer (and paying an additional five years of interest) than with the extended plan.

Neither extended repayment nor consolidation is the best option for those who are looking to get the lowest possible monthly loan payment. Those who need to minimize their monthly loan payment as much as possible likely should choose the Income-Based Repayment plan which will be available beginning July 1, 2009.